TESTIMONY RESPECTFULLY SUBMITTED TO COMMITTEE FOR PURCHASE FROM PEOPLE WHO ARE BLIND OR SEVERELY DISABLED

On

PROPOSED RULES ON NONPROFIT AGENCY GOVERNANCE AND EXECUTIVE COMPENSATION

By

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At
THE COMMITTEE'S PUBLIC HEARING
DALLAS, TEXAS
JANUARY 19, 2006
(Revised January 29, 2006)

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Good morning Mr. Chairperson and Members of the Committee,

Thank you for the opportunity to provide testimony on your proposed rules on Nonprofit Agency Governance and Executive Compensation. I applaud the Committee for taking the initiative to protect the integrity of the JWOD program and the employment opportunities that it has provided and continues to provide to individuals with severe disabilities and blindness. In this era of post Enron corporate scandals, Sarbanes-Oxley and the recent scandals of United Way of America and the allegations of questionable governance and accountability of the American Red Cross, we need to raise the proverbial "bar" for transparency and accountability in the sector. I fully endorse your intent, as stated in the advanced NPRM of December 16, 2005, "that accountability, stewardship, and value from the foundation for maintaining and growing employment opportunities for people who are blind or have other severe disabilities....appropriate to review its regulations and policies to insure proper accountability standards, provide effective stewardship, and demonstrate a strong value proposition for Federal customers." I would suggest that this statement applies to everything that we do for all of our funders at Anixter Center and this should be true for all similar agencies functioning in today's increasingly competitive and complex, multi-level regulatory environment.

My name is Allan I. Bergman and during the past eighteen months, I have been privileged to serve as the President and CEO of Anixter Center, a large and diverse community agency that is 86 years old, is Chicago's 13th largest charity according to Crain's Business Magazine and provides an array of community services and supports to over 5,000 individuals with disabilities per year. We have an annual operating budget of over $33 million, employ nearly 450 staff and have a collective bargaining unit of Local 20 of Service Employees International (SEIU), which has been in existence for twenty five years. As part of our array of services and supports, we are a JWOD contractor with GSA and that revenue source and the jobs that it creates for forty-six individuals with disabilities, accounted for 3.74% per cent of our total revenues in FY '05.

During the past thirty-eight years, I have served as the CEO of five other Nonprofit agencies; two at the local level in Texas, including one here in Dallas; one at the local level in California; one at the state level in Colorado; and, one at the national level inside the Beltway.

During my eighteen years at the national level, I spent twelve years as the Director of Governmental Relations and the Director of State-Federal Relations for United Cerebral Palsy Associations, Inc. and six years as the President and CEO of the Brain Injury Association of America. In both of these positions, I provided a great deal of training and technical assistance to our local and state affiliate volunteers and staff on organizational and board development. I thus bring you a perspective of someone who has seen the evolution of the roles and responsibilities of Boards of Directors and individual directors from the days of the purely volunteer "mom and pop" agencies to the availability of government funds and letting the staff do it all with volunteers putting their name on a letterhead, showing up for a meeting or two, attending a fundraiser and making a donation to the organization to today's evolving best practice standards from

BoardSource and Independent Sector and the emerging theories, texts and training sessions on alternative models of governance from Carver to Drucker to Tecker, among others. I also am an active member of the American Society of Association Executives (ASAE) and serve as a member of its Key Philanthropic Organizations Committee.

I have carefully reviewed the advanced NPRM and your request for comments and will respond to them. In some cases, where there is overlap, I will answer several questions together.

Qualified Agencies Have Good Governance Practices:

You list fourteen practices and then ask the following questions:

(1) Are these criteria comprehensive and inclusive enough to effectively evaluate that a nonprofit agency demonstrates good governance practices and should be deemed qualified to participate in the JWOD Program?
(2) Are there additional criteria that should be used, or substituted for the above, to evaluate evidence of good governance practices by nonprofit agencies in the Program?

I believe that the fourteen practices are a good start and, in general, are consistent with the recommendations in the report <u>Strengthening Transparency, Governance and Accountability of Charitable Organizations</u>, published in June of 2005 by the Panel on the Nonprofit Sector convened by the Independent Sector; however, the items do not represent 2006 best practice as defined by my recent experiences in a major board development process at Anixter Center as well as in numerous recently published materials by Board Source, the primary source of high quality materials in non profit governance and leadership. I have, therefore, suggested some additions by the use of italicized and underlined type:

(1) The board of directors (the board) should <u>*define and periodically review the mission of the organization*</u> and be composed of individuals who are personally committed to the mission of the organization and possess the specific skills needed to accomplish the mission, <u>*and accept their duty as stewards of the public trust.*</u>
(2) I strongly recommend that NO employee of the organization should be a VOTING member of the Board. The CEO should serve as a NON VOTING ex-officio member of the Board and all committees. I base this on personal experience and legal counsel. In addition, <u>*The Board should adopt and periodically review a written job description for the Board of Directors.*</u>
(3) Although most states allow as few as three board members to incorporate, I recommend that no functioning agency board should have less than seven to eleven members in order to have the diversity and skills necessary to fulfill the governance functions. With only five members and a fifty percent quorum, three members constitute a quorum and a majority vote would be two people running the corporation. I find that frightening.
(4) "The organization's bylaws should set forth term limits <u>*and a process of rotation/staggered terms*</u> for the service of board members." Many "experts"

suggest three, three year terms as the term limit in order to bring in "new blood".

(5) No change

(6) No change

(7) Item 7 and 14, as written, are inconsistent. Although the Board may delegate a committee (usually the Executive Committee) to facilitate the CEO processes, the Board must spend Board time in Executive Session on these issues. "The full board should hire the executive director, set the executive's compensation, support the executive director, and formally evaluate the director's performance at least annually."

(8) This proposal does not make a great deal of practical sense for a large organization with a competently staffed human resources department that must study the labor market, deal with a union contract, etc. This function belongs to management within a set of broad, board approved personnel policies.

(9) No change

(10) One additional sentence to a fine statement.... "Each member of the board will sign the conflict of interest annually and more frequently if any material changes occur in the director's circumstances."

(11) "The accuracy of the agency's financial reports should be subject to <u>an annual independent</u> audit by a Certified Public Accountant. The board of directors should have at least one "financial expert" serving. <u>*Agencies with annual budgets of $10 million or greater should have an Audit Committee separate from the Finance Committee.*</u>

(12) No change

(13) No change

(14) I agree with the intent of the statement and the need for the agency to comply with the Internal Revenue Code. As a result of discussion with legal counsel, I have learned that the staff who should be addressed are those whose salary is over $90,000 per annum (as adjusted by the IRS) ***who make decisions that significantly impact the financial condition of the organization.*** This would include, the CEO, CFO, Program Director or comparable titles, and the number of individuals will vary from organization to organization. In my agency, this standard could involve eight to ten people. I should clarify that your proposed language is too restrictive and has the potential to undermine the authority of the CEO, who is the only direct employee of the Board. The Board should NOT be setting individual salaries except for that of the CEO. An alternative is for the Board to periodically establish salary ranges for each of the "highly compensated individuals" and to adopt some explicit policies governing compensation for these individuals, which are to be administered by the CEO during an annual review process. These policies must be benchmarked in the community of the organization for organizations of comparable budget and number of employees, etc.

Therefore, I would rewrite the item as follows: "Executive compensation paid to the Chief Executive Office (CEO)/President must be monitored by the board of directors. The full board should approve all compensation packages for the CEO/President through a "rebuttable presumption" process to determine reasonableness. The Board should develop a compensation policy for employees who are highly compensated and who make decisions significantly impacting the financial decisions of the organization. The Board also should provide salary ranges for these employees, to be administered by the CEO.

This process should be consistent with the IRC 4958; 26 C.F.R. '53.4958-T, as follows: There is a rebuttable presumption that a compensation arrangement is reasonable if

- *The compensation arrangement was approved by the Board composed entirely of individuals who do not have a conflict of interest with respect to the transaction.*
- *The Board obtained and relied upon appropriate data in determining compensation comparability.*
- *The Board adequately documented the basis of its compensation decision within 60 days of the decision and properly reported the decision.*
- *An organization manager can rely on a reasoned, written opinion of legal counsel, a CPA, or a valuation expert (after full disclosure of the facts) that a transaction is not an excess benefit transaction.*

I also recommend the following additional "best practices" be added to the list in the final rule:

A. The board should adopt a code of ethics.
B. The board should assure active oversight of the financial affairs of the organization through the approval of an annual budget and monitoring through timely financial statements.
C. The organization should provide appropriate insurance coverage for board members through directors and officers' liability insurance.
D. The board should ensure adequate resources.
E. The board should ensure effective organizational planning through participation in and formal adoption of the strategic plan.
F. The board should enhance the organizations public standing.

(3) Should accreditation by one or more state or national organizations be recognized as evidence of a nonprofit agency adhering to good governance practices without further review by the Committee?

I do not believe that the accreditation process provides a level of certainty that the Committee desires. The area of governance is not a major area of expertise of the accrediting bodies.

Therefore, I strongly recommend that the Committee agree upon a final list of required policies and practices and issue them as a final rule. In addition, I recommend that the Committee develop a Declaration/Certification Form with each of these characteristics listed and defined for each organization to review, individually check and to submit the Certification Form annually as part if its Form 404 Report, this Declaration/Certification Form to be signed by the following four individuals: the Chair and Treasurer of the Board and the President and CEO

and the CFO with appropriate citations regarding penalties for fraudulent information.

(4) Should different benchmarks be used for nonprofit agencies that are state, county, or local government agencies, or should they be exempt from any Committee regulations in this area?

They should be exempt because of the public accountability under which they operate.

(5) Should the size and/or the annual revenue of the nonprofit agency be a factor or factors in assessing appropriate governance practices?

No, good governance is good governance. The one exception would be the removal of the need for a separate audit committee in small organizations.

(6) What is the best way to ensure that only qualified central nonprofit agencies and nonprofit agencies, with an internal structure that minimizes opportunities for impropriety, participate in the JWOD Program?

Please see the response to question (3) above through the signed Declaration/Certification Form.

(7) What if any enforcement mechanism should be adopted to ensure only the qualified central nonprofit agencies and nonprofit agencies participate in the JWOD Program?

Same as (3) and (6) above.

(8) What steps will the nonprofit agencies and central nonprofit agencies need to take to avoid conflicts of interest among its board members?

The assertion that the agency has a Conflict of Interest Policy, a Code of Ethics and that these are current and followed, as signed by the four signatories on the Declaration/Certification Form.

(9) What steps will the nonprofit agencies and central nonprofit agencies have to take to demonstrate financial responsibility?

The agency can declare/certify the following: that it has a Board approved annual budget that is monitored at least quarterly by the Board; that it has an annual independent audit; that it deposits all payroll taxes in a timely manner; and that it completes and files an annual 990 in a timely manner.

Effect of Executive Compensation on Fair Market Price Determinations:

(1) What is the threshold beyond which the compensation paid to the executives in a JWOD-participating nonprofit agency should be considered as influencing a proposed fair market price determination? For example, if the agency receives

more than a certain percentage of its total revenue from sales through the JWOD Program, is there a compensation level (total dollars paid or total dollars paid as a percentage of total revenue) at and above which fair market price impact would be deemed to occur?

(2) Conversely, is there a point below which executive compensation, regardless of the dollar amount paid, would not be considered as influencing a recommended fair market price? Is such a *de minims* test appropriate for large diversified nonprofits where total JWOD sales represent only a small percentage of total revenue?

(3) Without regard to any analysis of JWOD-related revenue, is there an established benchmark or absolute dollar threshold above which compensation would be deemed as influencing a proposed fair market price?

I do not believe that there is an absolute dollar threshold that could equitably take into account the vast differences in cope, complexity, product and array of services, population of people with a full range of types and severity of disabilities, rehabilitation, Medicaid and other government funding sources, community needs, and a patchwork of varying federal, sate, and local regulatory requirements of the nearly 650 nonprofit agencies that participate in the JWOD Program.

In regard to recent assertions and /or speculations that higher CEO compensation on the part of a producing JWOD Non-Profit Agency (NPA) has a direct effect on JWOD Fair market Prices, this does not comport with the facts as I understand them.

First, JWOD contract prices are tied to prices from the commercial market. The Committee's guidelines, Pricing Memorandum #3 (PR3), require that prices proposed by NPA's be tied to actual prices paid in the commercial market for the same or similar services. In fact, the General Services Administration Public Buildings Services (GSA/PBS), with which Anixter Center continues to do business after many years, established Market pricing agreements that explicitly tie agreed to prices to the commercial market. GSA/PBS prices are benchmarked against a very in-depth commercial market pricing indicator that is calculated by an independent third party on a rolling quarterly basis.

Second, JWOD contracts are fixed price contracts which differ significantly from other contract vehicles such as fixed price plus incentive fee, cost plus time and material contracts. The contractor is not able to claim increases in any rates or costs associated with the contract unless expressly agreed to by the parties at the time the contract is initiated. The risk for increased costs not associated with increased labor or health and welfare rates is solely the responsibility of the NPSA. In other words, even if an NPA wanted to pay excessive salaries or bonuses, these costs cannot be added to the pricing calculation because of the fixed price nature of the contract.

(4) Should receipt of documentation to support a "rebuttable presumption of reasonableness" serve to demonstrate that executive compensation does not by itself influence a proposed fair market price or any adjustment thereto?

As stated previously in response to several of the questions on Governance, I recommend that the Committee develop a Declaration/Certification form that is to be reviewed and signed annually by the Chair and Treasurer of the Board and the President and CEO and the CFO as part of the Form 404 Report. The relevant area of the Form would comport with the components of the IRC cited above.

(5) To what extent should there be a relationship between the pay and compensation of line workers and highly compensated individuals?

To the maximum extent possible, existing law and regulation including Internal Revenue Service law and regulation, the Service Contract Act and the Fair Labor Standards Act should govern this process. Federal laws and regulation govern the determination of compensation for both line workers and highly compensated individuals. NPA's should be expected to follow the spirit and letter of all applicable laws and regulations regarding the determination of compensation for both line workers and highly compensated individuals with equal vigor so that they can competitively recruit, hire and retain the most talented individuals throughout all levels of the organization. The JWOD Strategic Plan is clear in its stated objective that improving the quality of jobs and compensation for line workers is a high priority. Any revised rules should increase emphasis on NPA accountability in this area with positive reinforcement, including perhaps the use of incentives.

(6) At what point would it be appropriate to begin a review of an executive compensation package even if the proposed price for a product or service would fall within a range that it could be considered as a fair market price?

To the maximum extent possible existing Internal Revenue Service laws and regulation should govern this process. The IRS currently is completing a study of over 1,000 NPA's to determine the scope of excess compensation and benefits. That report is expected shortly. The case law suggests that if the NPA has followed the steps for the "rebuttable presumption of reasonableness" and there is question as to the potential excess of the compensation, then the burden of proof is on the IRS to review the evidence and determine that the compensation was excessive. Since violation of these regulations result in intermediate sanctions, fines and potential loss of the agency's 501 (c) 3 tax exempt status, that should be incentive enough for the agency to follow the law. If the NPA does not satisfactorily complete the proposed Declaration/Certification Form described above, then the Committee could choose to pursue the matter itself or refer it to the IRS. Finally, as stated earlier, the assumption that price is influenced by excessive executive compensation is not the case when examining the facts in a market based system using fixed-price contracts.

(7) What approaches are available to identify and monitor nonprofit agencies executive compensation that would provide such information to the Committee routinely but without placing an undue burden on agencies?

I continue to recommend, as above, that the Committee develop a comprehensive list of Governance best practices, including the IRS required process steps to establish executive compensation and incorporate them into a Declaration/Certification form that must be completed annually and signed by the Chair and Treasurer of the Board and the President and CEO and the CFO.

I would like to make one final point. As stated earlier, one size does not fit all on some of the governance best practices. Moreover, each NPA is at a different level of competency in the best practices defined above. Therefore, if the Committee believes that the implementation of these rules truly will improve the transparency and accountability of the JWOD Program, as I do, then I would encourage the Committee to work with the National Agencies to provide funding for NPA board and staff leadership training and technical assistance in these practices and to allow NPA's up to twenty four months to achieve compliance on the best practice governance rules other than the already mandated IRS policy on compensation.

Thank you for the opportunity to provide my testimony and perspective on the advance NPRM. I will be happy to answer any questions and look forward to working further with the Committee in developing the proposed final rule.

I also am attaching the following: Anixter Center's Board of Directors job description, Conflict of Interest Statement and Independent Sector's Code of Ethics.